

No. 10202

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IN THE
UNITED STATES
CIRCUIT COURT OF APPEALS
FOR THE NINTH CIRCUIT

COMMISSIONER OF INTERNAL REVENUE,
Appellant,

vs.

STIMSON MILL COMPANY, *Appellee.*

ON PETITION FOR REVIEW OF THE DECISION OF THE
UNITED STATES BOARD OF TAX APPEALS

BRIEF FOR THE APPELLEE

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OPINION BELOW

The opinion of the Board of Tax Appeals (R. 20-24) is reported at 46 B.T.A. 141.

JURISDICTION

Appellee adopts the statement on jurisdiction set out in Appellant's brief.

QUESTIONS PRESENTED

Section 112(b) (6) of the Revenue Act of 1938 provides that no gain or loss shall be recognized upon receipt by a parent company of property distributed in "complete liquidation," provided certain specified conditions are met.

The issues raised are:

1. There was not a distribution "in complete liquida-

tion" within the meaning of Section 112(b) (6) (A), (B), (C) and (D) of the Revenue Act of 1938.

2. If it is held that there was a distribution "in complete liquidation" within the meaning of said section and subsections the word "property" does not include money.

STATUTE INVOLVED

Revenue Act of 1938, C. 289, 52 Stat. 447:

"SEC. 112. RECOGNITION OF GAIN OR LOSS.

* * * * *

"(b) Exchanges Solely in Kind.—

* * * * *

"(6) Property received by corporation on complete liquidation of another.—No gain or loss shall be recognized upon the receipt by a corporation of property distributed in complete liquidation of another corporation. For the purposes of this paragraph a distribution shall be considered to be in complete liquidation only if—

"(A) The corporation receiving such property was, on the date of the adoption of the plan of liquidation, and has continued to be at all times until the receipt of the property, the owner of stock (in such other corporation) possessing at least 80 per centum of the total combined voting power of all classes of stock entitled to vote and the owner of at least 80 per centum of the total number of shares of all other classes of stock (except nonvoting stock which is limited and preferred as to dividends), and was at no time on or after the date of the adoption of the plan of liquidation and until the receipt of the property the owner of a greater percentage of any class of

stock than the percentage of such class owned at the time of the receipt of the property; and

“(B) No distribution under the liquidation was made before the first day of the first taxable year of the corporation beginning after December 31, 1935; and either

“(C) The distribution is by such other corporation in complete cancellation or redemption of all its stock, and the transfer of all the property occurs within the taxable year; in such case the adoption by the shareholders of the resolution under which is authorized the distribution of all the assets of such corporation in complete cancellation or redemption of all its stock, shall be considered an adoption of a plan of liquidation, even though no time for the completion of the transfer of the property is specified in such resolution; or

“(D) Such distribution is one of a series of distributions by such other corporation in complete cancellation or redemption of all its stock in accordance with a plan of liquidation under which the transfer of all the property under the liquidation is to be completed within three years from the close of the taxable year during which is made the first of the series of distributions under the plan, except that if such transfer is not completed within such period, or if the taxpayer does not continue qualified under subparagraph (A) until the completion of such transfer, no distribution under the plan shall be considered a distribution in complete liquidation.

“If such transfer of all the property does not occur within the taxable year the Commissioner may require of the taxpayer such bond, or waiver of the statute of limitations on assessment and

collection, or both, as he may deem necessary to insure, if the transfer of the property is not completed within such three-year period, or if the taxpayer does not continue qualified under subparagraph (A) until the completion of such transfer, the assessment and collection of all income, war-profits, and excess-profits taxes then imposed by law for such taxable year or subsequent taxable years, to the extent attributable to property so received. A distribution otherwise constituting a distribution in complete liquidation within the meaning of this paragraph shall not be considered as not constituting such a distribution merely because it does not constitute a distribution or liquidation within the meaning of the corporate law under which the distribution is made; and for the purposes of this paragraph a transfer of property of such other corporation to the taxpayer shall not be considered as not constituting a distribution (or one of a series of distributions) in complete cancellation or redemption of all the stock of such other corporation, merely because the carrying out of the plan involves (i) the transfer under the plan to the taxpayer by such other corporation of property, not attributable to shares owned by the taxpayer, upon an exchange described in paragraph (4) of this subsection, and (ii) the complete cancellation or redemption under the plan, as a result of exchanges described in paragraph (3) of this subsection, of the shares not owned by the taxpayer."

STATEMENT

The Appellee adopts the statement of Appellant.

STATEMENT OF POINTS TO BE URGED

Section 112(b) (6) of the Revenue Act of 1938 does not apply because:

1. There was no distribution in "complete liquidation" within the meaning of Section 112(b) (6), (A), (B), (C) and (D) of the Revenue Act of 1938.
2. The term "property" as used in Section 112(b) (6) does not refer to money.

SUMMARY OF ARGUMENT

1. There was no distribution in complete liquidation because:

- A. No plan of liquidation was ever adopted.
- B. A distribution was made before the first day of the first taxable year of the corporation beginning after December 31, 1935, and,
- C. The transfer of all the property did not occur within the taxable year, or
- D. The distribution was not in accordance with a plan of liquidation under which the transfer of all of the property under the liquidation was to be completed within three years from the close of the taxable year during which is made the first of a series of distributions under the plan.

2. The reading of the entire Supplement B, Sections 111 to 121 all relating to the subject of computation of net income, repeatedly refers to "property" and to "money." The legislative intent to differentiate between property and money is thus shown.

From the Committee reports referred to in Appellant's brief, in relation to the legislative history of the Act, interpretation Appellant would draw therefrom does not necessarily follow.

ARGUMENT

A. Introduction

In its 1938 income tax return Appellee claimed a capital loss measured by the difference between its tax basis and the total of distributions received by it except that the loss claimed was limited to \$2,000 pursuant to other provisions of the 1938 Act not material to any issue herein. The only question is whether the Commissioner was correct in disallowing the loss upon the ground that Section 112(b)(6) of the 1938 Revenue Act applies to the facts stipulated to by both parties.

The Appellee has at all times contended, and before the Board of Tax Appeals urged, that the facts definitely preclude the application of Section 112(b)(6) (R. 18). Although the Board of Tax Appeals predicated its decision upon the interpretation of the word "property," as used in Section 112(b)(6), as excluding money, Appellee's principal contentions were not predicated upon the interpretation of the word "property" appearing in Section 112(b)(6). While Appellee believes that the Board of Tax Appeals correctly interpreted the word "property" as not including money, Appellee again, as it did before the Board of Tax Appeals, will urge that the first and real issue is, under the facts of this case, was there a distribution in complete liquidation within the provision of Section 112(b)(6)? A decision as to whether the word "property" as used in Section 112(b)(6) includes money, is necessary only if it is held that there was a distribution "in complete liquidation" within the provisions of Section 112(b)(6), (A), (B), (C) and (D).

Before the question as to whether or not the word "property," as used in Section 112(b)(6), includes money is considered, it is necessary to determine whether there was a distribution "in complete liquidation" within the meaning of said section. This question is not argued in Appellant's brief.

Were it not for the provisions of Section 112 every gain in complete liquidation would be taxable and every loss in complete liquidation deductible. Section 112(b)(6) prescribes specific conditions that must be met for the taxpayer to avoid tax on certain gains. These same conditions must be present if the claim for loss is to be denied.

To state the statute is to state the answer. No extended argument is necessary. No previously decided cases raising this issue have been found by Appellee, probably for the reason that the provisions of Section 112(b)(6), (A), (B), (C) and (D) are so clear as not to require interpretations.

Section 112(b)(6) provides "for the purpose of this paragraph a distribution shall be considered to be in complete liquidation *only if * * **" (Emphasis supplied) the following conditions are met:

1. The adoption of a plan of liquidation (112(b)(6)(A) and (C) or (D)) and
2. The corporation receiving the distribution was at all times from the adoption of a plan of liquidation to the date of final distribution in liquidation the owner of at least 80% of the combined voting power of all the capital stock (112(b)(6)(A)) and
3. "No distribution under the liquidation was made before the first day of the first taxable year of

the corporation beginning after December 31, 1935" (112(b)(6)(B)) and

4. The distribution occur within the taxable year after the adoption of the plan (112(b)(6)(C)) or
5. If the distribution is one of a series in accordance with the plan of liquidation under which the liquidation is to be completed within "three years from the close of the taxable year during which" the first of the series of distribution under the plan is made (112(b)(6)(D)).

B. Distributions were made before December 31, 1935

Section 112(b)(6)(B) specifically requires that in order for the section to apply "no distribution under the liquidation was made before the first day of the first taxable year of the corporation beginning after December 31, 1935 and * * *." (The conditions set forth in subsections (C) or (D) also apply.)

Distributions were made by Second-Holding Corporation in 1931, 1932, 1937 and 1938 (R. 14). This fact standing alone precludes the application of Section 112(b)(6).

C. No plan of liquidation adopted within the provisions of Section 112(b)(6)(C) or (D)

Sub-sections (C) and (D) are stated in the alternative. Either the distribution in "complete cancellation or redemption of all" the stock must occur within "the taxable year" or "within three years * * * from the close of the taxable year during which is made the first of a series of distributions" under a plan of liquidation adopted by resolution of the stockholders.

Second-Holding Corporation was organized in 1930

for the sole purpose of selling certain real property acquired in exchange for its capital stock. The proceeds were to be distributed to the Appellee. Such distributions were made in 1931, 1932, 1937 and 1938 (R. 14).

Unquestionably the 1938 distribution was one of a series over a period of eight or nine years. During this period of time Second-Holding Corporation served its purpose. It was never dissolved. It was abandoned (R. 15) and the authorization therefor secured six months after the final distribution (R. 14). The stipulation of the parties is conclusive of the fact that there never was a plan of liquidation within the intentment of Section 112(b) (6). Paragraph 13 states:

“13. The minute book of Second-Holding Corporation contains no record of any meeting wherein either liquidation or dissolution was discussed or wherein any distributions of any kind were authorized.” (R. 15)

and paragraph 14 further states:

“14. No steps were taken to dissolve Second-Holding Corporation, but it was abandoned forthwith, immediately after the meeting, the minutes of which is attached as Exhibit A.” (R. 15)

If it can be said that any “plan” of liquidation ever existed, it must be found in the purpose for which Second-Holding Corporation was organized and such a plan would not fall within the limits of Section 112(b) (6) (C) or (D). The distributions were in pursuance of its purpose and extended over a period of eight years.

In conclusion Appellee submits that there were no distributions “in complete liquidation” because the

facts do not bring the case within subsections (B) and (C) or (D) of Section 112(b) (6).

D. Property does not include money

The Board of Tax Appeals decision was predicated upon an interpretation of the word "property" as excluding "money." The fair intendment of the statute is set out in the cogent reasoning of Member Sternhagen. We can do no better than adopt his opinion in this respect.

Appellant, being hard pressed to meet this argument, has attempted to gain support for his position from a Committee Report of the 75th Congress quoted on page 17 of his brief. The weakness of his argument rests in the fact that:

1. Section 112(b) (6) was introduced into the Revenue Statute by the Act of 1936 and was re-enacted without change in the Revenue Act of 1938.
2. The Revenue Act of 1938 introduced Section 112(b) (7) into the tax structure. This subsection provides for the non-recognition of gain on certain distributions in liquidation *except to the extent that money or certain recently acquired securities are distributed*.¹

¹Section 112(b) (7) Revenue Act of 1938 Public—No. 554—75th Congress, Chapter 289, 3rd Session (52 Stat. 447):

"(A) *General Rule*.—In the case of property distributed in complete liquidation of a domestic corporation, if—

- (i) the liquidation is made in pursuance of a plan of liquidation adopted after the date of the enactment of this Act, whether the taxable year of the corporation began on, before, or after January 1, 1938; and

3. The quotation from the Committee Report concerns changes initiated in the Revenue Act of 1938 (Appellant's brief page 17) and is obviously in error in stating that Section 112(b) (7)

(ii) the distribution is in complete cancellation or redemption of all the stock, and the transfer of all the property under the liquidation occurs within the month of December, 1938—

then in the case of each qualified electing shareholder (as defined in subparagraph (c)) gain upon the shares owned by him at the time of the adoption of the plan of liquidation shall be recognized only to the extent provided in subparagraphs (E) and (F).

“(B) * * *

“(C) * * *

“(D) * * *

“(E) *Noncorporate Shareholders*.—In the case of a qualified electing shareholder other than a corporation—

(i) There shall be recognized, and taxed as a dividend, so much of the gain as is not in excess of his ratable share of the earnings and profits of the corporation accumulated after February 28, 1913, such earnings and profits to be determined as of December 31, 1938, but without diminution by reason of distributions made during the month of December, 1938; and

(ii) There shall be recognized, and taxed as short-term or long-term capital gain, as the case may be, so much of the remainder of the gain as is not in excess of the amount by which the value of that portion of the assets received by him which consists of *money*, or of stock or securities acquired by the corporation after April 9, 1938, exceeds his ratable share of such earnings and profits. (Emphasis supplied)

“(F) *Corporate Shareholders*.—In the case of a qualified electing shareholder which is a corporation the

permits the distribution of money without recognition of gain to the distributee.²

4. Section 115(h) (Revenue Act of 1938) which is the subject of the comment in the Committee Report (Appellant's brief page 17) refers to "property" and "money" in the alternative rather than "property" as including "money." Its effect is merely to give equal treatment to both in the event no gain or loss is recognized on the distribution.³

gain shall be recognized only to the extent of the greater of the two following—

(i) The portion of the assets received by it which consists of *money*, or of stock or securities acquired by the liquidating corporation after April 9, 1938; or

(ii) Its ratable share of the earnings and profits of the liquidating corporation accumulated after February 28, 1913, such earnings and profits to be determined as of December 31, 1938, but without diminution by reason of distributions made during the month of December, 1938. (Emphasis supplied)

²See Note (1) *supra*.

³Section 115 Revenue Act of 1938. Public—No. 554—75th Congress, Chapter 289, 3rd Session (52 Stat. 447):

"(h) *Effect on Earnings and Profits of Distributions of Stock.*—The distribution (whether before January 1, 1938, or on or after such date) to a distributee by or on behalf of a corporation of its stock or securities, of stock or securities in another corporation, or of *property or money*, shall not be considered a distribution of earnings or profits of any corporation (Emphasis supplied)—

(1) if no gain to such distributee from the receipt of such stock or securities, *property or money*, was recognized by law, or (Emphasis supplied)

(2) if the distribution was not subject to tax in

Little weight can be given to a Committee Report as interpretative of a reenactment of a prior law (Section 112(b)(6) Revenue Act of 1938) wherein the presence of such an obvious mis-interpretation of a current enactment (Section 112(b)(7) Revenue Act of 1938) appears. Such weight as might otherwise attach to this Committee Report is nullified by the language of the Amended Section 115(h).⁴

CONCLUSION

Appellee submits that there is no deficiency in income tax for the calendar year 1938 for the reasons herein stated.

Respectfully submitted,

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the hands of such distributee because it did not constitute income to him within the meaning of the Sixteenth Amendment to the Constitution or because exempt to him under Section 115(f) of the Revenue Act of 1934 or a corresponding provision of a prior Revenue Act.

“As used in this subsection the term ‘stock or securities’ includes right to acquire stock or securities.”

⁴See Note 3.